MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa1 rating to St. Charles' (IL) $4.8M GO Bonds, Series 2013B

Global Credit Research - 24 Oct 2013

Aa1 applies to $95M of post-sale GOULT debt

ST. CHARLES (CITY OF) IL
Cities (including Towns, Villages and Townships)
IL

Moody's Rating

ISSUE	RATING
General Obligation Bonds, Series 2013B	Aa1
Sale Amount $4,800,000	
Expected Sale Date 10/31/13	
Rating Description General Obligation	

Moody's Outlook

Opinion

NEW YORK, October 24, 2013 –Moody's Investors Services has assigned a Aa1 rating to the City of St. Charles' (IL) $4.8 million General Obligation Bonds, Series 2013B. Moody's maintains a Aa1 rating on the city's outstanding general obligation debt, affecting $95 million post-sale. The current issuance is secured by the city's general obligation unlimited tax pledge. Proceeds from the Series 2013B bonds will be used for various capital, electric, and wastewater projects.

SUMMARY RATING RATIONALE

Assignment of the Aa1 rating reflects the city's sizeable, mature and affluent tax base; sound financial operations supported by solid operating reserves despite some declines in operating revenues; and a slightly above average debt burden with limited future borrowing plans.

STRENGTHS

- Overall stable economy located in Chicago (GO rated A3/negative outlook) metropolitan area

- Significant revenue raising flexibility afforded by Home Rule status

- Strong financial operations and solid reserve levels; alternate liquidity in Capital Fund

CHALLENGES

- Dependence on economically-sensitive sales tax revenues

- Structurally imbalanced operations in some of the city's TIF funds

DETAILED CREDIT DISCUSSION

MATURE AFFLUENT SUBURB LOCATED NEAR CHICAGO

Located in Kane (GO rated Aa1) and DuPage (GO rated Aaa) counties, St. Charles experienced assessed valuation growth through 2008, driven by its proximity to Chicago and surrounding metropolitan employment centers. Reflecting the broader real estate downturn, the city's full valuation has declined slightly less than 6.0%

annually from 2010 to 2012 bringing the five year average annual growth rate to a negative 2.6%. While the city is almost fully built-out and future development efforts will continue to focus on redevelopment, two single family residential developments are expected to be completed over the next year. The city's formerly vacant Pier 1 Distribution center is now occupied by a printing company that has added approximately 180 new jobs. Q Center LLC and Pheasant Run Resort and Convention Center continue to have a significant presence in the city. Accenture Consulting currently leases the Q Center campus for use as an employee training facility. Residents enjoy numerous employment opportunities within the Chicago metro area. The city's unemployment rate of 7.7% for July 2013 is significantly lower than the rates for state (9.6%) and on parity with that of the nation (7.7%) for the same time period. Income indices exceed national medians with per capita and median family incomes at 153.8% and 153.2%, respectively, according to the American Community Survey five-year estimates for 2006 - 2010.

STRONG FINANCIAL OPERATIONS SUPPORTED BY SOLID RESERVES; GENERAL FUND SUPPORT FOR TIF BACKED DEBT EXPECTED TO CONTINUE

The city's financial operations remain sound following prudent and proactive management practices during the economic downturn. The city continues to be supported by solid operating reserves, a demonstrated history of reacting quickly to budgetary challenges, significant alternate liquidity outside of the General Fund and a high degree of revenue raising flexibility inherent in being a home rule municipality. The city's General Fund benefits from a diverse composition of revenue sources, both discretionary and non-discretionary. The largest source of revenue historically has been sales tax (both state shared and Home Rule) accounting for 37.7% of General Fund revenues in fiscal 2012. Property taxes are the second largest revenue stream at 32.2%, with the remaining revenue sources comprised of state shared income tax receipts, charges for services, as well as hotel, utility, and telecommunication taxes. Despite revenue pressures, the city's General Fund balance continues to trend well above the city's official policy of maintaining 25% of budgeted expenditures in reserves. At fiscal yearend 2012, the total General Fund balance has reserved $3.0 million in advances to other funds and assigned $3.0 million for Community Development debt service. Outside of these reservations, the General Fund's unassigned balance was a solid $16.2 million, or 41.9% of revenues at the end of fiscal 2012.

Beginning fiscal 2008, the city began experiencing declines in sales tax revenues along with other economically sensitive revenue categories. In response, the city enacted a 2% across the board budget reduction beginning in fiscal 2009. The city reduced its operating budget by approximately 12% over two years (fiscals 2009 and 2010) to address revenue shortfalls and remain structurally balanced. Expenditure cuts included reductions in head count through voluntary retirement and attrition, as well as a wage freeze for all employees. Officials also increased other revenues, including a new alcohol beverage tax effective June 1, 2010.More recently, the city posted a moderate $120,000 surplus at the close of fiscal 2012 despite the loss of $1.8 million in revenue from an expired fire protection services contract with a nearby district. The surplus was primarily driven by a continued rebound in economically sensitive revenues, with sales tax collections increasing by approximately $535,000 or 3.8%, and hotel occupation taxes increasing by approximately $137,000 or 8.5%. For fiscal 2013, which ended on April 30, 2013, city officials report that, despite budgeting for a sizeable operating deficit the General Fund posted a $1.46 million surplus due in part to project funds not expended. The city is budgeting for a deficit in fiscal 2014 due to the expenditure of these project funds. Over the two year period, net of project funds, the city should have surplus operations of approximately $700,000.

In addition to the General Fund, the city has alternate liquidity in its Capital Projects Fund. While these funds are earmarked for capital projects, they are available for General Fund operations should it become necessary, further strengthening the city's reserve levels. Providing additional financial flexibility to the city's credit profile is its status as a Home Rule unit of government. Home Rule governments in Illinois are not subject to levy limits, have no statutory debt ceiling, and can impose a variety of taxes, including sales, utility, hotel, and food/beverage.

The city oversees three enterprise operations: water, sewer and electric. The city's electric enterprise fund had a negative unrestricted net asset position of $3.9 million but a positive cash position of $616,000 at the close of fiscal 2012. Officials report rate increases for the electric fund in fiscals 2012 and 2013 following a rate study should result in positive operations in 2013. Additionally, the city has six tax increment financing districts. As of April 30, 2013, the city's TIF District #2, #3, #4, and #5 funds had a total deficit balance of approximately $3 million and owe the General Fund approximately $3.7 million, primarily due to annual transfers to cover debt service payments as increment revenues are insufficient. Officials expect the General Fund will be repaid with future tax increment revenues as development occurs.

DEBT BURDEN EXPECTED TO REMAIN MANAGEABLE SUPPORTED BY NON-LEVY SOURCES; AVERAGE PENSION LIABILITY

The city's direct and overall debt burdens, at 2.3% and 5.3% of estimated full value, respectively, are somewhat above average but manageable given significant use of alternate revenue sources for repayment. Over 96% of the city's general obligation debt is paid from the city's various operating revenue streams and do not require support from the city's debt service property tax levy, which is abated on an annual basis. As a result, the city consistently makes large transfers from the General Fund to the Debt Service Fund to support debt service costs. None of the city's debt is in variable rate mode and the city is not party to any interest rate swap agreements.

Moody's adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, was $78.7 million as of 2011. This includes the city's liability under the Illinois Municipal Retirement Fund (IMRF), a statewide plan, and two single employer defined benefit pension plans for its public safety workers. This liability is equal to an average 1.28 times operating revenues, compared to a median ratio of less than 1.0 times for rated local governments. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported contribution information, but to improve comparability with other rated entities.

WHAT WOULD CHANGE THE RATING - UP

-Substantial growth in the city's tax base

-Improved performance across the city's TIF districts

WHAT WOULD CHANGE THE RATING - DOWN

-Significant erosion of the city's tax base and/or declines in the city's demographic profile

-Significant deterioration in General Fund reserves

-Ongoing General Fund support for the city's TIF districts that negatively impacts the city's operations or reserves

KEY STATISTICS

2010 Census population: 32,974 (18.0% increase from 2000)

2012 Full Valuation: $4.2 billion (2.6% decrease from 2007)

2012 Full Value per capita (estimate): $125,000

Direct debt: 2.3%

Overall debt: 5.3%

Fiscal 2012 General Fund balance: $22.4 million (57.8% of revenues)

2006 - 2010 American Community Survey per capita income as a % of U.S.: 153.8%

2006 - 2010 American Community Survey median family income as a % of U.S.: 153.2%

Moody's Adjusted Net Pension Liability: 1.28 times operating revenues

Post-sale general obligation debt outstanding: $95 million

PRINCIPAL METHODOLOGY USED

The principal methodology used in this rating was General Obligation Bonds Issued by US Local Governments published in April 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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